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# AUDITABILITY: AN ANALYSIS OF THE DONS FINANCIAL SYSTEMATIC ISSUES

Bolinsky, Teri; Zuniga, Andres F.

Monterey, CA; Naval Postgraduate School

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# **NAVAL POSTGRADUATE SCHOOL**

**MONTEREY, CALIFORNIA**

## **THESIS**

### **AUDITABILITY: AN ANALYSIS OF THE DON'S FINANCIAL SYSTEMATIC ISSUES**

by

Teri Bolinsky and Andres F. Zuniga

December 2019

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**AUDITABILITY: AN ANALYSIS OF THE DON'S FINANCIAL SYSTEMATIC  
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## **ABSTRACT**

The purpose of this research is to identify financial systematic issues surrounding the Department of the Navy's (DoN) lack of auditability and its inability to obtain an unqualified opinion. This study explores possible reasons the DoN failed the audit, using the process and internal controls components of the auditability triangle. The authors review audit reports, DoN financial reports, accounting error reports, subject matter expert interviews, and reported financial systematic issues that contribute to audit issues. The research findings identified issues related to audit readiness, feeder systems and processes, and internal controls. Research findings show lack of accuracy and completeness of the DoN's financial statements. The findings indicate that the DoN should consolidate and standardize its financial systems, feeder systems, and processes across the organization. The findings also indicate that the DoN lacks reliable, effective, and compliant internal controls. Based on these findings, recommendations are provided for further focus on auditability, feeder systems and processes, and internal controls to improve audit readiness across the DoN.



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## LIST OF ACRONYMS AND ABBREVIATIONS

ADA	Anti-Deficiency Act
CAP	corrective action plan
CFO Act	Chief Financial Officer Act
COSO	Committee of Sponsoring Organizations
CMC	Commandant of the Marine Corps
CMT	commitment
DDRS	Defense Departmental Reporting System
DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DECC	Defense Enterprise Computing Center
DoD	Department of Defense
DoDIG	Department of Defense Inspector General
DoD OIG	Department of Defense Office of Inspector General
DoN	Department of the Navy
DTS	Defense Travel System
EXP	expense
EY	Ernst and Young
FASAB	Federal Accounting Standard Advisory Board
FBwT	Funds Balance with Treasury
FIAR	Financial Improvement and Audit Readiness
FISMA	Federal Information Security Modernization Act of 2014
FFMIA	Federal Financial Management Improvement Act of 1996
FLGL	field level general ledger
FMFIA	Federal Managers' Financial Integrity Act of 1982
FMP	financial management program
FMS	foreign military sales
FY	fiscal year
GAAP	Generally Accepted Accounting Principles
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office

GCSS-MC	Global Combat Support System—Marine Corps
GE-R	PP&E—general equipment remainder
GL	general ledgers
IRB	Institutional Review Board
LIQ	liquidation
MC	Marine Corps
MCO	Marine Corps Financial Management Standard Operating Procedures, Marine Corps Order
MLSR	multi-national service requests
NFR	notifications of findings and recommendations
NFT	Navy Fund Balance with Treasury Tool
NULO	Negative Unliquidated Obligations
OBL	obligation
OMB	Office of Management and Budget
OM&S	Inventory and Operating Materials and Supplies
OSD	Office of the Secretary of Defense
POM	Performance Objective Memorandum
PP&E	Property, Plant, and Equipment—real property
PR Builder	Purchase Request Builder
SABRS	Standard Accounting, Budgeting, and Reporting System
SBR	statement of budgetary resources
SECDEF	Secretary of Defense
SECNAV	Secretary of Navy
SFFAS	Statement of Federal Financial Accounting Standards
SOA	Statement of Assurance Report
STARS	Standard Accounting and Reporting System
UMD	Unmatched Disbursements
USMC	United States Marine Corps

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## **I. INTRODUCTION**

In this chapter, the background, research purpose, and research questions are discussed. The methodology is briefly defined along with the benefits, scope, and organization of this research.

### **A. BACKGROUND**

Corporations use financial statement audits to provide creditability and minimize risk to allow investors to make informed financial decisions. A true and fair representation of a company's financial performance and position is the foundation for audited financial statements. Just as corporations need audited financial statements to demonstrate and reflect their performance, the federal government also needs audited financial statements to provide the public proper spending records. In contrast to corporations, which answer to stakeholders, the government uses financial statement audits to ensure taxpayers' money is allocated properly and spent with minimal fraud, waste, and abuse. The Navy and Marine Corps, hereafter referred to as the Department of the Navy (DoN), have been under scrutiny to ensure compliance and financial improvements take place, aiming toward a complete financial audit in order to obtain an unqualified opinion.

The Department of Defense (DoD) created the Financial Improvement and Audit Readiness (FIAR) plan to institute a timeline and framework to assist individual service agencies in complying with auditing regulations. The fiscal year (FY) 2014 FIAR timeline contained a plan for different DoD organizations to achieve an audit-ready statement of budgetary resources (SBR) by the end of fiscal year (FY) 2014 and set the date of September 30, 2017, as the deadline for being in compliance of audit readiness (Department of Defense, 2013). Currently, there are 10 general ledgers (GLs) being utilized to manage the DoN's finances, creating an unstandardized financial accounting system for the department (Office of Financial Policy and Systems [FMP], 2018, p. 4). These GLs support sophisticated and highly customized financial feeder systems, requiring many interfaces and workarounds (plugs) and resulting in a lack of transactional traceability and

issues with accuracy. Due to the complexity of these financial systems, it is challenging for the DoN and the DoD to achieve an unqualified audit opinion of their financial statements.

Additional financial feeder systems have been created to manage and operate areas such as logistics, shipping, mobility, transportation, supply, multi-national requests (MLSR), foreign military sales (FMS), and others. These financial feeder systems create financial information that is sent to the accounting systems to generate specific financial transactions. With the complex integration of financial feeder systems and GLs, an agency's internal controls must comply with the Federal Managers' Financial Integrity Act (FMFIA) of 1982. During the *2018 Statement of Assurance*, the DoN received 20 discrepancies associated with financial reporting and five nonconformances related to financial systems (DoN, 2018b). According to Rendon and Rendon (2016), striving for effective internal controls and capable processes, as defined in the Auditability Triangle Framework, are important. The framework, which consists of personnel, internal controls, and processes, could be utilized by the DoN to establish a plan for addressing these discrepancies.

## **B. RESEARCH PROBLEM**

This research is focused on the DoN's inability to receive an unqualified opinion from the DoD's mandated financial statement audit requirement. The DoN has yet to receive an unqualified opinion (DoD, 2013; Hale, 2014).

## **C. RESEARCH PURPOSE**

The purpose of this research is to identify financial systematic issues surrounding the DoN's lack of auditability and its inability to obtain an unqualified opinion. Issues related to financial system frameworks in order to be audit-ready are explored. This research study explores and further analyzes possible reasons the DoN failed the audit, using the process and internal controls components of the auditability triangle. Audit reports, DoN financial reports, accounting error reports, subject matter expert interviews, and reported financial systematic issues that contribute to audit issues are reviewed.

## **D. RESEARCH QUESTIONS**

The research questions are related to the research purpose and the research problem. This research study answers the following research questions:

1. Using the auditability triangle theory, what are the audit readiness issues that led to the failed audit for the DoN?
2. Using the process component of the auditability triangle theory, what are the feeder systems and process issues that led to the failed audit for the DoN?
3. Using the internal controls component of the auditability triangle theory, what are the internal control issues that led to the failed audit for the DoN?

## **E. METHODOLOGY**

This research study was conducted using a mixed-method strategy that included an in-depth literature review, subject matter expert interviews, and analysis of data obtained from operational commands. The data used in this research was retrieved by reviewing and analyzing financial management articles, such as RAND reports and other research studies. Government Accountability Office (GAO) reports, Department of Defense Inspector General (DoDIG) reports, and DoD financial audit reports were also reviewed. In order to provide an illustration of a feeder system process, an example of accounting records from individual DoN units was provided.

## **F. BENEFITS AND IMPORTANCE OF THIS RESEARCH**

Obtaining an unqualified opinion during the next DoD-wide audit is a key focus for the DoN. This research provides insight into the complex financial feeder systems used by the DoN and information on possible solutions to the problems with the current financial systems, and the DoN's inability to obtain an unqualified audit opinion. Additionally, this research will serve as a baseline for further analysis in order to understand the complex issues surrounding the DoN financial management and the relationship between financial feeder systems, accounting systems, auditability, and internal controls. This research



identifies any issues preventing the DoN from being audit-ready using terminology that can be understood by financial and non-financial managers.

## **G. SCOPE AND ORGANIZATION**

This research paper contains five chapters. Chapter I is the introduction, which provides a brief background, research purpose, research questions, methodology, benefits and importance of this research, as well as the scope and organization. Chapter II provides the literature review of auditing in the DoN, financial process management issues, and internal controls within the DoN. Chapter III explains the methodology used for this research. Chapter IV discusses the analysis of the research findings from the literature review and the interviews. Chapter V provides a summary of the research conducted and provides recommendations for further research.

## **H. SUMMARY**

This chapter provided an introduction and background on audit readiness and the DoD and DoN's goal of obtaining an unqualified opinion. It presented the research questions addressed in this study. Followed by the methodology, it discussed how the interview data was collected. The importance of this research and the overall organization of this research paper were also discussed. Chapter II is a literature review that covers the history of audit readiness, feeder systems and processes, and internal controls.

## **II. LITERATURE REVIEW**

### **A. INTRODUCTION**

This literature review includes peer-reviewed articles and government documents related to financial accountability, internal controls, and financial systems. This chapter first reviews the literature on financial accountability used in the Department of Navy (DoN) leading up to and following the Department of Defense (DoD)-wide audit and the regulations that were established to get the DoD in compliance with these regulations. Next, the chapter discusses audit readiness and accounting issues that have occurred in the DoN followed by a discussion of DoD/DoN/Marine Corps (MC) audits, and the notifications of findings and recommendations (NFRs) final reports. Next, auditability triangle and its associated components of personnel, processes, and effective internal controls are presented. A brief understanding of the financial accounting systems and processes used for government accounting concerning financial feeder systems and financial accounting systems that feed into the general ledgers (GLs) is discussed as well as the transaction life cycle and accounting key performance metrics. Next, the COSO internal control framework is presented and further explained in its relationship to the federal government agencies. Financial accountability is discussed in the following section.

### **B. FINANCIAL ACCOUNTABILITY**

Financial accountability is a critical component in the operations and development of organizations across a vast array of industries to include the government and private sectors. In 1989, Apostolou and Apostolou (1989) released a report discussing the steps required for the government to improve financial audit quality. The original report was performed by the Government Accounting Office, now known as the Government Accountability Office (GAO). According to Apostolou and Apostolou (1989), “34% [audits of government funds reviewed] contained departures from applicable auditing standards” (p. 73). Finding the departures from established standards, resulted in the development of the Task Force on the Quality of Audits of Governmental Units in March 1987 (p. 73). A GAO report in 1990 discussed that additional initiatives for improving

audit quality led to the establishment of the Chief Financial Officer Act (CFO Act) by Congress (Chief Financial Officers Act, 1990). The CFO Act states that federal agencies will conduct comprehensive and independent yearly financial audits (Chief Financial Officers Act, 1990). These audits will include financial statements as described in the FASAB (Federal Accounting Standard Advisory Board [FASAB], 2018). The Financial Improvement and Audit Readiness (FIAR) plan required the DoD to be audit-ready by September 30, 2017 (Hale, 2014). As shown in Figure 1, four waves were initially presented to meet this goal.

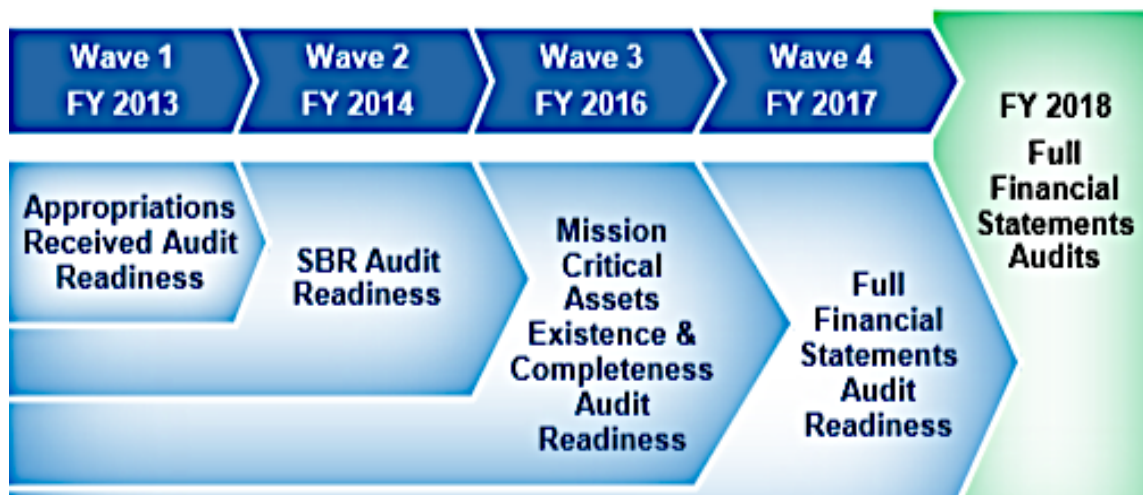


Figure 1. FIAR strategy and timeline. Source: Hale (2014).

The goal of the FIAR was to minimize or eliminate the negative impact on the DoD's financial statements by correcting material misstatements. Wave 1 of the FIAR strategy and timeline focused on ensuring that the appropriations could support a full audit with the ability to provide all necessary documents to reflect the needed data presented on the financial statements. Wave 2 focused on the SBR and on ensuring that all financial reports were audit-ready. Wave 3 aimed to ensure that all mission-critical assets were accurately accounted for with respect to the managerial assertions of existence and completeness. Completeness has to do with the recording of all financial transactions from source documents to the actual general ledgers. Wave 4 focused on the completion of a full financial statement audit while incorporating all data from the previous three waves. A

required step during waves 2, 3, and 4 is the completion of a Tri-Annual Review. The DoD FMR requires that a Tri-Annual Review should be conducted to ensure that the requirements of proper management and control of obligations are being met (DoD, 2017). The Tri-Annual Review process is a key control that enables the use of unexpired appropriations and provides assurance that financial statements state valid obligations. (DoD, 2017). According to a GAO report from 2017, the DoD did not possess the ability to prepare appropriate, trustworthy, and reasonably accurate financial statements (Khan, 2017). In the next section, audit readiness and accounting issues are discussed.

### **C. AUDIT READINESS AND ACCOUNTING ISSUES**

Previous to the Navy's 2018 audit, a 2016 GAO investigation disclosed the need for improvements in the audit readiness for the Fund Balance with the Treasury (Khan, 2016). This investigation concluded that the Navy's financial reporting process "lacks sufficient and appropriate policies and procedures to identify, detect, and correct inaccurate and incomplete balances in the general ledger, which impact the balances reported on the face of the financial statements, accompanying footnotes, and related disclosures" (Khan, 2016). Additionally, the GAO found that the Navy was unable to reconcile the Funds Balance with Treasury (FBwT) "ending balances from the field level general ledger (FLGL) systems and Defense Departmental Reporting System (DDRS) directly to the U.S. Treasury" (Khan, 2016). In an effort to reconcile the issues between the U.S. Treasury and the Navy's general ledger, the Defense Finance and Accounting Service (DFAS) created the Navy Fund Balance with the Treasury Tool (NFT). According to the report, design deficiencies and operational deficiencies have been identified and "the lack of policies, procedures, internal controls, and supporting documentation prevents the Navy from substantiating the completeness, existence, accuracy, rights, and obligations related to FBwT" (Khan, 2016). According to Khan, the combination of these deficiencies results in a material weakness for FBwT.

In 2017, the GAO investigated the financial management efforts for remediating audit readiness deficiencies (Khan, 2017). The 2017 GAO report examined the 2015 Budgetary Schedules for the different branches of military service and reviewed the

processes designed by each branch. The report focuses on the integrated audit findings and recommendations of the 2015 scheduled audit and evaluates the process that monitors and reports the audit readiness corrective action plan. The GAO concluded that all military services lacked adequate processes and procedures in identifying financial management deficiencies, which relates to the process component of the auditability triangle. Overall, the DoD requires appropriate methods to properly record, execute, and report its audit remediation efforts. The GAO report stated the importance of the four-step process framework established by the FIAR for military services to address their findings and recommendations. The framework includes steps to identify and track deficiencies, prioritize deficiencies, develop corrective action plans (CAPs) to “remediate them, and monitor the implementation status of the CAPS” (Khan, 2017). Due to lack of complete and detailed information within CAPs, the DoD Comptroller’s office could not determine if military services were making progress. As identified in the FIAR, which serves as a guide to the military services in the path to auditability, the current reports do not provide comprehensive information to internal and external stakeholders, such as the DoD Office of Inspector General (DoD OIG), Office of Management and Budget (OMB), GAO, and Congress, on the status of audit readiness. The overall finding of the GAO report is that none of the three services could provide sufficient evidence showing processes in place for remediating all four components of the financial management deficiencies previously identified (Khan, 2017).

The Secretary of the Navy (SECNAV) released a statement to the Secretary of Defense (SECDEF) discussing the results of the annual statement review required under the Federal Managers’ Financial Integrity Act for FY2018 (Spencer, *Annual Statement Requirement Under the Federal Managers’ Financial Integrity Act for Fiscal Year 2018*, 2018b). In this memorandum, the SECNAV disclosed that the DoN’s internal controls over the financial systems did not meet the standards of FFMIA and *OMB Circular No. A-123, Appendix D*, due to five nonconformance items (Spencer, 2018b). The five nonconformance items include the following:

1. The Navy ERP system is not complying with the Standard Financial Information Structure (SFIS)

2. Standard Accounting and Reporting System- Field Level (STARS-FL) deficiencies include interface issues, business process transaction policy, procedures, and documentation issues along with master data issues
3. USMC Global Combat Support System (GCSS) Deficiencies
4. STARS-FL has numerous deficiencies in the areas of SOD, reconciliation, pre-validation edit checks, and other internal controls
5. The DoD Information Assurance Certification and Accreditation (DIACAP) failed to produce the audit ready control environment. (Spencer, 2018b, p. 97)

The Statement of Assurance Report (SOA) discussed the material weakness related to internal controls, financial reporting material misstatements, and the financial management systems material weaknesses and nonconformances (Spencer, 2018b). The following two sections discuss these weaknesses. The next section discusses the U.S. Navy's results from the 2018 audit.

#### **D. U.S. NAVY FY2018 ANNUAL FINANCIAL REPORT RESULTS**

The U.S. Navy FY2018 Annual Financial Report discusses “the audit conducted on the U.S. Navy General Fund FY2018 Financial Statements and internal controls over financial reporting and compliance with laws and regulations” (Spencer, 2018a). Ernst and Young (EY), an independent public accounting firm, was contracted to conduct the audit on the U.S. Navy General Fund FY2018 financial statements following the guidance principles in the Generally Accepted Government Auditing Standards (GAGAS), OMB, and GAO. The audit resulted in a disclaimer of opinion, and EY was not able to determine whether the financial statements were following the Generally Accepted Accounting Principles (GAAP) (Spencer, 2018a). Additionally, an internal control audit was conducted to test the financial systems. This audit, as disclosed in the *United States Navy General Fund Fiscal Year 2018 Annual Financial Report: Accountability to America*, identified 13 material weaknesses, 10 addressing internal controls over the financial reporting and three addressing financial information systems. These material weaknesses included the following:

1. Financial reporting
2. Fund balance with treasury
3. Accounts payable
4. Government property in the custody of contractors
5. Property, Plant, and Equipment (PP&E)—real property
6. PP&E—general equipment remainder (GE-R)
7. PP&E—general equipment valuation
8. Inventory and related property, such as operating materials and supplies for remainder
9. Inventory and related property, such as operating materials and supplies for ordnance
10. Oversight and monitoring
11. Financial information systems—access controls and segregation of duties
12. Financial information systems—configuration management
13. Financial information systems—interface processing. (Spencer, 2018a, pp. 42-47)

The immediate focus for the DoN is outlined in the eight areas of audit deficiencies the SECNAV prioritize (Deputy Assistant Secretary of the Navy (Budget), 2019). The eight areas include the following:

1. Accounting Systems: Reducing the total accounting systems footprint to two by the end of FY 2020, with the ultimate goal of one accounting system by the end of FY 2021.
2. Business Systems Consolidation: Developing a business systems architecture and reengineering business processes to guide information technology (IT) modernizations.
3. Financial Reporting: Streamlining the financial statement preparation process, fixing process and system deficiencies that create adjustments to DON financial statements.
4. Fund Balance with Treasury: Streamlining business process to reconcile the DoN's financial records to Treasury's and transition to Treasury shared services for payment and collection operations.
5. Inventory and Operating Materials and Supplies (OM&S): Clarifying and re-engineering supply chain management busies processes to have 100 percent accountability of inventory and OM&S.
6. Real Property: Conducting 100 percent inventory count of real property and improving the end-to-end processes to maintain accountability of real property assets.
7. Budgetary Reform: Enforcing discipline in the DoN's funds' distribution process and intragovernmental transactions.

8. IT General Controls: Implementing risk management framework and correcting deficiencies in access and security controls over our systems. (DoN, 2019, pp. 9–10 and 9–11)

The next section discusses the results of the FY2018 financial reports of the U.S. Marine Corps.

#### E. U.S. MARINE CORPS FY2018 AGENCY FINANCIAL REPORT RESULTS

An extensive report is available from Kearney & Company, an independent public accounting firm, outlining the results of the FY2018 Agency Financial Report (United States Marine Corps, 2018) and the DoD Inspector General (DoDIG) report No. DoDIG-2019-011. According to the report, Kearney & Company’s 2017–2018 audit resulted in a disclaimer of opinion. Kearney & Company provided a separate report discussing the material misstatements over financial reporting even though the Marine Corps was not able to provide sufficient and appropriate evidence to complete the audit. Appendix A of the report (shown in Figure 2) reflects prior year findings and provides a starting point for the 2018 audit, which also resulted in a disclaimer of opinion.

In the *Independent Auditor’s Report on Internal Control over Financial Reporting* included with the audit report on the United States Marine Corps’ (Marine Corps) fiscal year (FY) 2017 financial statements, several issues noted were related to internal control over financial reporting. The status of the FY 2017 internal control findings is summarized in *Exhibit 1*.

***Exhibit 1: Status of Prior-Year Findings***

Control Deficiency	FY 2017 Status	FY 2018 Status
Entity-Level Controls	Material Weakness	Material Weakness
Ability to Provide Complete, Timely, and Sufficient Evidence	Material Weakness	Material Weakness
Financial Reporting and Analysis	Material Weakness	Material Weakness
Integrated Financial Management Systems	Material Weakness	Material Weakness
Property, Plant, and Equipment (PP&E)	Material Weakness	Material Weakness
Operating Materials and Supplies (OM&S)	Material Weakness	Material Weakness
Fund Balance with Treasury (FBWT)	Material Weakness	Material Weakness
Business Process Controls	Material Weakness	Material Weakness
Information Systems	Material Weakness	Material Weakness

Figure 2. USMC status of prior year findings. Source: United States Marine Corps (2018).



Although the Marine Corps used prior year findings to prepare and guide the 2018 audit, most material weaknesses identified in 2017 were also identified in 2018. Additionally, insufficient evidence prevented the completion of the audit during both years (Figure 2). The schedule of findings of the report was divided into four main areas. The four areas are the Federal Managers' Financial Integrity Act of 1982 (FMFIA), the Federal Information Security Modernization Act of 2014 (FISMA), the Federal Financial Management Improvement Act of 1996 (FFMIA), and the Anti-Deficiency Act (ADA). Although Kearney and Company's findings are clear, some of the underlying issues causing the results are not detailed in the report. Kearney & Company also adds the following statement to the report:

In accordance with Government Auditing Standards and OMB Bulletin No. 19-01, we have also issued reports, dated November 7, 2018, on our consideration of the Marine Corps' internal control over financial reporting and on our tests of the Marine Corps' compliance with provisions of applicable laws, regulations, contracts, and grant agreements, as well as other matters for the year ended September 30, 2018. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance and other matters. Those reports are an integral part of an audit performed in accordance with Government Auditing Standards and OMB Bulletin No. 19-01 and should be considered in assessing the results of our audits. (United States Marine Corps, 2018, p. 5)

A significant effort has been set forward by the DoN since Congress directed the annual audit of financial statements. However, issues continue to prevent the completion of a full audit for the DoN. As General Neller, 37th commandant of the Marine Corps, states in the initial letter of the report, "The Marine Corps is committed to the accountability and reform required to make audit readiness a critical enabler of warfighting readiness" (United States Marine Corps, 2018). General Neller also states "that the auditor's report in this Agency Financial Report (AFR) tells us what we already knew; we have a lot of work to do" (United States Marine Corps, 2018). The issues leading to an incomplete audit seem to be clear, and the solutions seem too complicated to reach. However, a basic understanding of the underlying problems is paramount to moving forward and finding

enduring solutions to a continuing problem. In the next section, the auditability triangle and the significance of being audit-ready are discussed.

#### **F. AUDITABILITY TRIANGLE**

In a 2016 article, Rendon and Rendon (2016) stated that “the theory of auditability incorporates three aspects of governance which emphasizes effective internal controls, capable processes, and competent personnel” (p. 755). The relationship between these components is depicted in Figure 3.

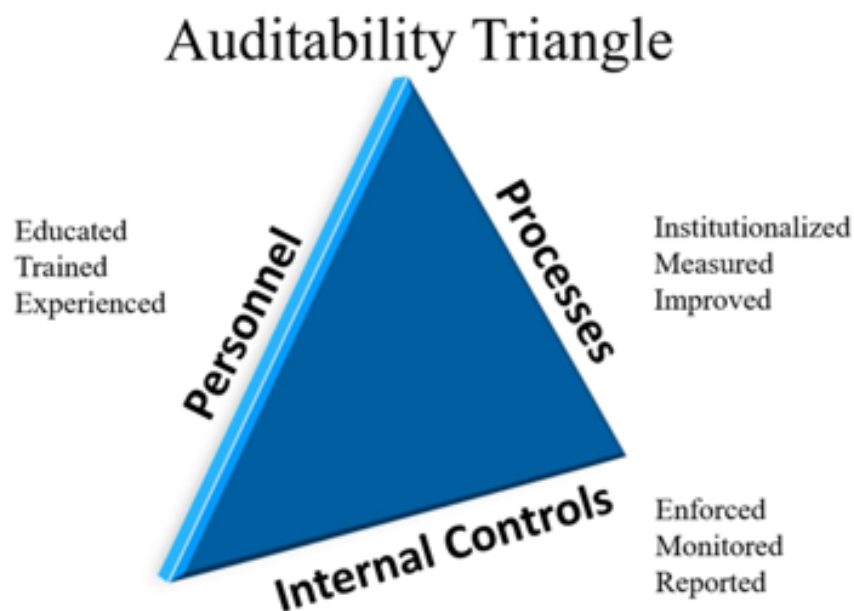


Figure 3. Auditability triangle. Source: Rendon and Rendon (2016).

As shown in Figure 3, the conceptual framework known as the auditability triangle describes the theory of auditability, which focuses on three components: processes, personnel, and internal controls (Rendon & Rendon, 2016). Douglas A. Brook (2011), former assistant secretary of the Navy (Financial Management and Comptroller) breaks down the auditing process as an unbiased, systematic gathering and evaluating of evidence to test assertions. Michael Power from the London School of Economics and Political Science stated that by “making things auditable, organizations could provide the transparency and assurance that they are operating ethically and within the accepted

guidelines” (Power, 1996, p. 289). Organizations must establish processes and procedures that allow for their auditability. Rendon and Rendon (2015) state that an agency can reduce its vulnerability to fraud, waste, and abuse by emphasizing the capability of the organization’s processes and the effectiveness of the organization’s internal controls (p. 718). Adequate internal controls are essential to audit readiness and are one of the three components of the auditability triangle, which will be discussed later.

The third component of the Auditability Triangle is personnel. Strong, competent personnel are essential for an organization to be auditable. Through training and reinforcement from those at the top, DoN and DoD personnel should understand their internal controls, processes, and the importance of being audit-ready (Maitner, 2013). The focus of this research is not on the personnel component of the auditability triangle. The focus of this research is on the process component and internal control component of the auditability triangle, which will be discussed later. The following section discusses the federal government accounting systems and processes.

## **G. ACCOUNTING SYSTEMS AND PROCESSES**

The federal government uses various accounting systems to administer the execution of financial resources. Organizations such as the GAO, OMB, Treasury, and the DoD design and manage fiduciary and operational standards across the U.S. government. As identified in the auditability triangle, capable processes must be institutionalized, measured effectively, and constantly improved (Rendon & Rendon, 2016). In order to deter financial fraud and ensure compliance with the government’s objectives, capable financial management processes must be established within the financial accounting and feeder systems (Rendon & Rendon, 2015). Currently, the U.S. Navy’s main financial system and general ledger is the Standard Accounting and Reporting System (STARS), which is undergoing a consolidation plan to merge with the U.S. Marine Corps’ financial accounting system. The Standard Accounting, Budgeting, and Reporting System (SABRS) is the Marine Corps’ official financial accounting system, and it is designed to comply with the required rules and regulations (United States Marine Corps, 2015). DFAS owns SABRS where the system infrastructure is housed by the Defense Information Systems Agency

(DISA) Defense Enterprise Computing Center (DECC) located in St. Louis, MO. According to the MCO 7300.21B, SABRS is described as follows:

SABRS was designed to record and report financial information to meet both proprietary and budgetary accounting requirements and provide an accounting and reporting system for the execution of received appropriations by the Marine Corps. SABRS is used to record and report the financial impact of source transactions that originate from various responsible officials via various financial feeder systems, to obtain goods and services required to support assigned unit and command missions. (United States Marine Corps, 2015)

SABRS transactions can be generated and will execute from three different sources, which are feeder systems, manual entries, and SABRS-generated transactions. Normally, SABRS transactions originate in the financial feeder systems. However, certain circumstances will trigger automatic transactions or will require manual intervention. These SABRS-generated transactions are referred to as “auto transactions” (United States Marine Corps, 2015). Although this is not the focus of the research, an example will be provided later to illustrate transactions generated from the Global Combat Support System—Marine Corps (GCSS-MC) and to illustrate the systematic issues in the transaction cycle impacting the ability to be audit-ready.

According to the FY2018 agency financial report, the Marine Corps is working on the material weaknesses identified in prior years. One of the financial vulnerabilities addresses integrated financial management systems (See Figure 4). Material weaknesses were identified in three areas as shown in Figure 4.

Material Weakness	Summary Description	Corrective Actions and Status
<b>4. Integrated Financial Management Systems</b>	<p>The material weakness identified deficiencies noted in three related areas:</p> <ul style="list-style-type: none"> <li>– Standard Accounting Budgeting and Reporting System (SABRS) Interface Controls</li> <li>– Feeder systems to SABRS reconciliations</li> <li>– Integration between Accountable Property Systems of Record (APSRs) and SABRS.</li> </ul>	USMC will develop policies, procedures, and the process narratives, as applicable, to outline the sequential file reconciliations process and establish purpose, scope, roles, responsibilities, management commitment, and coordination among organizational entities. Corrective actions are estimated to be completed by 4th quarter 2021.

Figure 4. FY2017 USMC material weaknesses. Source: United States Marine Corps (2018).

The following section describes the transaction life cycle in the Marine Corps' financial accounting system.

## H. TRANSACTION LIFE CYCLE

The transaction life cycle in the Marine Corps' general ledger (SABRS) is a four-step cycle, as shown in Figure 5: Commitment (CMT), Obligation (OBL), Expense (EXP), and Liquidation (LIQ).



Figure 5. Funding life cycle. Source: U.S. Marine Corps (2015).

The Commitment begins the life cycle by setting aside the funding for a valid requirement, followed by the Obligation, which is the legally binding transaction. The third step is the Expense, which takes place when goods or services are delivered or completed, and the final step is the Liquidation, which happens when the U.S. Treasury releases the funds for payment. The complete definitions of the life cycle, according to the Marine Corps Financial Management Standard Operating Procedures, Marine Corps Order (MCO) 7300.21B, can be found in Appendix B.

The four-step process makes the Marine Corps accounting and reporting unique. Additionally, it poses a challenge to produce and maintain supporting documentation for audit purposes. As previously mentioned, there are three sources of input, which compounds the problem exponentially. According to a 2018 financial report, the Marine Corps cannot “provide complete, timely, and sufficient evidence” of controls and financial transactions (United States Marine Corps, 2018). Multiple corrective action plans (CAP) have been created and developed at different levels of the organization (United States Marine Corps, 2018). However, limitations in the financial systems are a critical friction point in solving the issue (United States Marine Corps, 2018). The following section discusses key performance metrics in the accounting system.

## **I. ACCOUNTING KEY PERFORMANCE METRICS**

The *Performance Metrics and Indicators Report* documents abnormal financial transactions posted in the SABRS or financial transactions that resulted in abnormal conditions. Abnormal financial transactions and conditions cast doubt on the validity and accuracy of the United States Marine Corps’ (USMC) financial data. Abnormal conditions and transactions can occur for a variety of reasons, including missing data elements, incorrect or absent SABRS table loads from other sources, manual input data errors, untimely monitoring of abnormal conditions, and conflicting supporting agency business practices.

Systematic errors or issues can occur at different stages of the fund’s life cycle, and the different stages determine the cause, detection, and resolution of the problem. The general breakdown of the key performance indicators is as follows: 1) Disbursement issues, which break down into unmatched disbursements (UMD) and negative unliquidated obligations (NULO); 2) spending errors and abnormal transactions, which take place during the interaction between financial feeder systems and SABRS; 3) reimbursable and direct cite errors occur when funding is transferred between commands, transferring of funding can happen internally or externally to the Marine Corps; 4) interest and discount errors, which normally occur during transactions with vendors and providers external to



The Marine Corps uses an intricate net of feeder systems to process and source requests in support of the operational forces for goods and services. All feeder systems must communicate with the Marine Corps general ledger, SABRS, to allow transfer of critical information. Transactions in SABRS, as previously mentioned, are normally generated in an external source, which in this case is referred to as a feeder system. Data is initially populated by the requirements generator(s) who are responsible for the initial request of goods and services. Consequently, the transaction will require a set of steps or approvals by different personnel to ensure the completion of the request and ultimately the payment of a final invoice. Each step will provide additional information to the overall transaction. This process is designed for time efficiency and accuracy during the reporting phases of the process. Examples of these financial systems are the Defense Travel System (DTS), Purchase Request Builder (PR Builder), and the GCSS-MC (United States Marine Corps, 2015).

While not the focus of the research, one of the researchers' work experience exemplifies the interaction between financial feeder systems and the accounting systems for the execution of appropriated funds. This example is provided as an illustration of the significance of the impact from the interaction between financial feeder systems and the general ledger and is illustrated in Table 2. During FY2017, the Marine Corps received the notification of finding and recommendation (NFR) #2017-FIN-024 Military Standard Requisition and Issue Procedures (MILSTRIP) Internal Controls over Price Adjustments. The NFR refers to the systematic inability to control price changes from a feeder system. The Marine Corps can place requisitions with other agencies such as the Defense Logistics Agency (DLA) or the Naval Medical Logistics Command (MEDLOG). Those requisitions generate a Military Standard Requisition and Issue Procedure—or MILSTRIP number—which becomes a transaction in the general ledger. In this case, the general ledger is SABRS. Due to the Anti-Deficiency Act (ADA) requirement, authorizing officials (AOs) approve transactions in the feeder system to ensure funds are available and subsequently obligated in SABRS. The issue arises whenever the Source of Supply (SOS) or vendor changes the price of the requisition, which can be done in the feeder system but does not update the price in the general ledger. In other words, the MILSTRIP does not reflect the



new price. Eventually, the payment will be made based on the invoice provided by the vendor, but it will not match the original obligation (OBL), creating a Negative Unliquidated Obligations (NULO). Every NULO generates three additional problems. First, commands are at risk of committing an ADA violation, and the NULO renders the initial AO approval pointless. Second, funds can be wasted because the adjustment of the OBL might take place after the FY is over. Third, the manual adjustment of the OBL can take place without supporting documentation. Although the DoN is working on reviewing and developing a Memorandum of Understanding to ensure all MILSTRIPS affected by price adjustments are re-approved, adjusted, or canceled prior to the liquidation (LIQ) of funds, the lack of a systematic solution still exists. This example reflects only one type of error and looks only at the MILSTRIP numbers. The next section presents a discussion of the five components in the COSO integrated internal controls framework.

## **K. COSO INTERNAL CONTROL FRAMEWORK**

The Committee of Sponsoring Organizations (COSO) was established in 1987 as a result of multiple corporations' financial irregularities (Grundfest & Berueffy, 1989). The COSO's mission was designed to examine the causes leading to the critical failures and develop ways that audit practices could be reviewed and modified to prevent future incidences. As defined by the *COSO 2013 Internal Control Integrated Framework Executive Summary*, internal control is defined as the "process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives, reporting, and compliance" (Committee of Sponsoring Organizations of the Treadway Commission [COSO], 2013). The integrated internal control framework includes five internal control components, and in 2013, COSO further defined them by including 17 principles related to the components as adapted by the list in Figure 7 (Cotton, Johnigan, & Givarz, 2016). The five main components of the COSO internal control framework (hereafter referred to as the Framework) include the control environment, risk assessment, information and communication, control activities, and monitoring activities (see Figure 7).

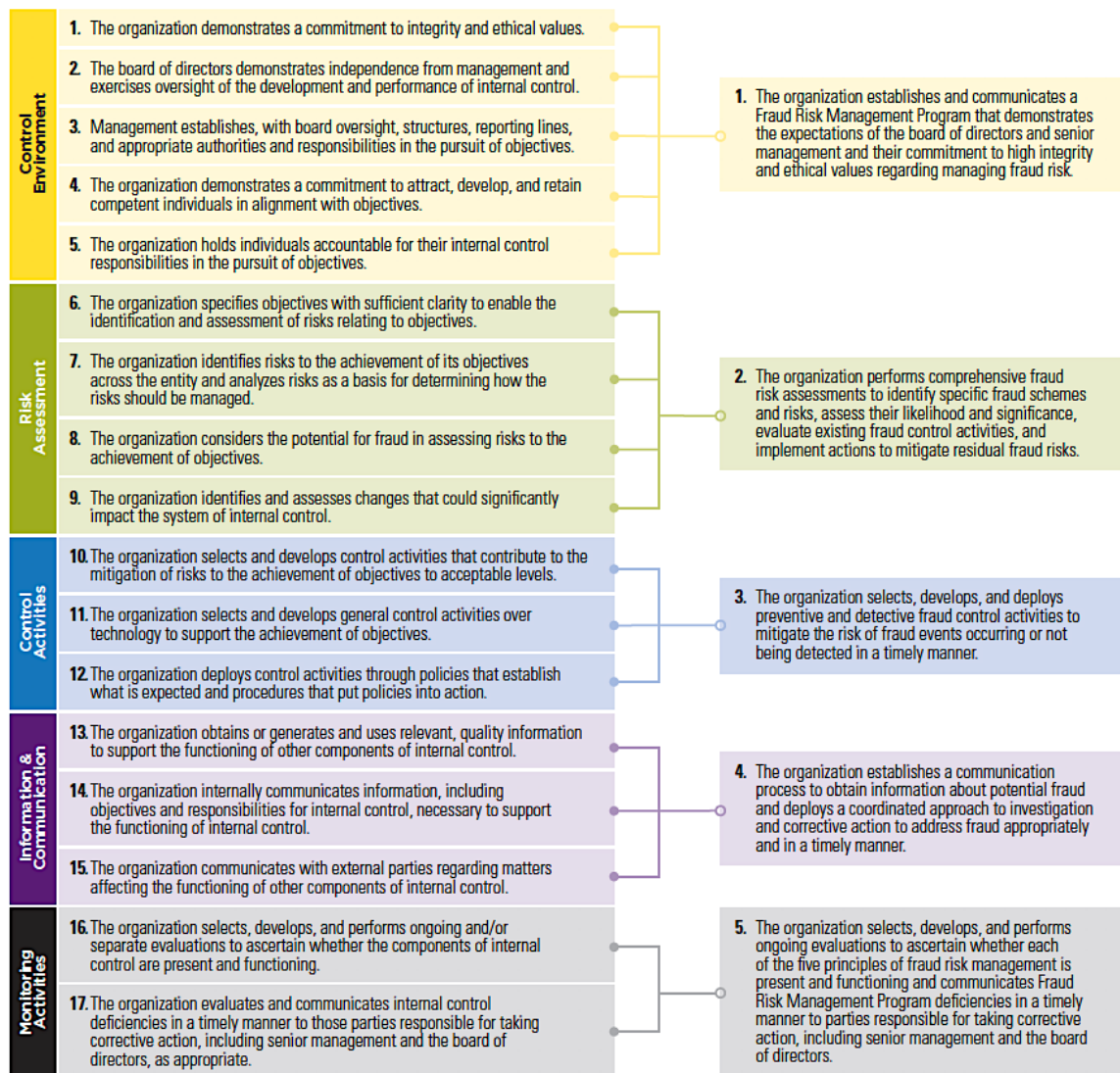


Figure 7. Internal Control Integrated Framework. Source: Cotton et al. (2016).

## 1. Control Environment

The first component of the Framework is the control environment. The control environment provides the primary structure of controls across all different types of entities. The COSO emphasizes the importance to create an environment that sets a good example from the leaders of the organization and portrays clear expectations over standards of conduct, truthfulness, and ethical values (COSO, 2013). In addition to the original outlines,

COSO added the following five additional principles to strengthen the control environment component:

- The organization demonstrates a commitment to integrity and ethical values.
- The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.
- Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
- The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
- The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives. (COSO, 2013, p. 6)

## 2. Risk Assessment

The second component of the Framework is risk assessment. Risk assessment's main objectives are to identify and manage potential risks that can be generated internally or from external entities (Pagnucco, 2015). Organizational risk assessment objectives include operating, reporting, and compliance. COSO's Framework added the following four new principles to enhance the risk assessment component:

- The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
- The organization identifies risks to the achievement of its objectives across the organization and analyzes risks as a basis for determining how the risks should be managed.
- The organization considers the potential for fraud in assessing risks to the achievement of objectives.
- The organization identifies and assesses changes that could significantly impact the system of internal control. (COSO, 2013, p. 7)

The risk assessment component is used to identify, analyze, and respond to risks, both internally and externally, from an organization. Daly (1997) discusses the importance of risk management and the reengineering process of internal controls. Daly (1997) suggests that agencies should conduct a risk assessment to identify and analyze potential

risks in relation to achieving its objective. To conduct this process, organizations should follow the COSO Internal Control Integrated Framework (Daly, 1997).

Academic research reveals that control environment and risk assessment, the first two components of the internal controls framework, “are relatively weak across organizations” (Hermanson, Smith, & Stephens, 2012). Continual changes in the operational environment diminish the effectiveness of control systems. Therefore, changes in the internal control system should be made to maintain the integrity of the organizational control systems. The effectiveness of internal controls will depend on the organizations’ capacity to adapt as changes are happening in their environment (COSO, 2013).

### 3. Control Activities

Control activities, the third component of the Framework, focuses on an organization’s execution and compliance with previously created risk mitigation directives and procedures (COSO, 2013). COSO’s new Framework adds the following three new principles to enhance the control activities component:

- The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
- The organization selects and develops general control activities over technology to support the achievement of objectives.
- The organization deploys control activities through policies that establish what is expected and procedures that put policies into action. (COSO, 2013, p. 7)

Control activities such as segregation of duties, performance reviews, and safeguarding of assets and records fall under these principles (Whittington & Pany, 2011). Unintentional errors can be mitigated by creating and maintaining segregation of duties since material errors can take place anywhere, even in well-managed organizations. Internal checks and balances improve and increase the reliability of financial reporting and safeguard assets, reports, and records (Porter, Simon, & Hatherly, 2014). Segregation of duties strengthens the execution of internal controls across organizations (Cosmin, 2011).

#### 4. Information and Communication

The fourth component of the Framework, information and communication, discusses critical information and the proper execution of responsibilities. COSO's new Framework adds the following three new principles to improve the information and communication component:

- The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.
- The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.
- The organization communicates with external parties regarding matters affecting the functioning of internal control. (COSO, 2013, p. 7)

This component includes an organizations' accounting system. Maintaining proper records and documentation assists in supporting the information and communication component of the Framework and allows departments to sustain accountability. Communicating and maintaining accurate records are paramount to ensuring that the proper financial executing, tracking, and reporting take place and have a positive impact on the overall well-being of the organization's overall state (Porter, Simon, & Hatherly, 2014). Information and communications must have specific purpose and should maintain the general characteristics of accuracy, objectiveness, clarity, completeness, and timeliness (Pitt, 2014).

#### 5. Monitoring Activities

Similar to the internal control component of the Auditability Triangle, which includes appropriate monitoring of internal controls, monitoring activities is the fifth component of the COSO Framework (COSO, 2013). Effective implementation, execution of tasks, and functioning principles of the organization are the primary purposes for the monitoring activities component of the Framework. COSO's new Framework adds the following two new principles to enhance the monitoring activities component:

- The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.
- The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate. (COSO, 2013, p. 7)

Utilizing the principles of internal control, management must demonstrate the commitment to accountability by developing and employing meaningful measures to assess performance (Tan, 2013). Additionally, management must create incentives and rewards that motivate and stimulate desired employee performance (Tan, 2013).

The next section presents a discussion of internal control guidance for federal government agencies.

#### **L. INTERNAL CONTROL GUIDANCE FOR FEDERAL GOVERNMENT AGENCIES**

In September 2014, the GAO released a report that discussed the standards for internal control in the federal government agencies. This report, also known as “*The Green Book*,” has the COSO internal control framework as its foundation (Dodaro, 2014). The GAO report defines internal controls as it pertains to the federal government and explains the process that should be used by management to help an entity achieve its objectives (Dodaro, 2014). Figure 8 shows the components of internal controls, categories of objectives, and levels of organizational structures.

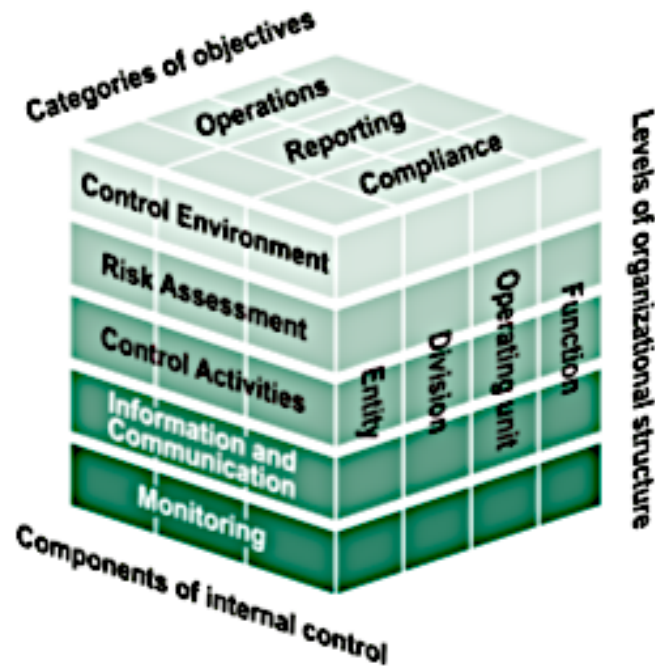


Figure 8. The components, objectives, and organizational structure of internal controls. Source: Dodaro (2014).

The top of the cube shows the categories into which an objective can be classified. The rows on the left side of the cube discuss the five components of the internal controls, which are control environment, risk assessment, control activities, information and communication, and monitoring (Dodaro, 2014). The right side of the cube shows the levels of organizational structure, which include function, operating unit, division, and entity (Dodaro, 2014).

In 1982, the Federal Managers' Financial Integrity Act (FMFIA) determined that an internal control system was to be developed and maintained across all DoD agencies. The Office of Management and Budget provided *OMB Circular A-123, Appendix D*, defining federal policy on internal control and management's responsibility for internal control (Springer, 2004). The responsibility to establish and maintain those controls is displayed in Table 1.

Table 1. Management’s responsibility for establishing and maintaining controls. Adapted from Springer (2004); Pagnucco (2015).

1. Develop and implement appropriate, cost-effective internal control for results-oriented management
2. Assess the adequacy of internal control in federal programs and operations
3. Separately assess and document internal controls over financial reporting consistent with the process defined in Appendix A
4. Identify needed improvements
5. Take corresponding corrective action
6. Report annually on internal control through management assurance statements

In a 2018 report to the SECDEF, SECNAV Richard V. Spencer acknowledged the importance of managing risks and maintaining adequate internal controls (Spencer, 2018a). The SECNAV has established an internal control system that would meet the objectives to provide reasonable assurance. The goals of these internal controls are to develop “effectiveness and efficiency of operations; reliability of financial and non-financial reporting; compliance with applicable laws and regulations; and financial information systems’ compliance with the Federal Financial Management Improvement Act (FFMIA) of 1996” (DoN, 2018a, p. 2). These objectives are similar to the COSO. The release of this report was made shortly before the release of the United States Navy General Fund FY18 Annual Financial Report, *Accountability to America*, which consolidated the DoN’s focus on correcting the deficiencies identified in the audit and reinforcing the SECDEF’s internal control objectives and priorities (Spencer, 2018a).

## M. SUMMARY

This chapter first reviewed the literature on financial accountability used in the Department of Navy (DoN) leading up to and following the Department of Defense (DoD)-wide audit and the regulations that were established to get the DoD in compliance with



these regulations. Next, the chapter discussed audit readiness and accounting issues that have occurred in the DoN followed by a discussion of DoD/DoN/Marine Corps (MC) audits, and the notifications of findings and recommendations (NFRs) final reports. Next, the auditability triangle and its associated components of personnel, processes, and effective internal controls were presented. A brief understanding of the financial accounting systems used for government accounting concerning financial feeder systems and financial accounting systems that feed into the general ledgers (GLs) were also discussed. The chapter concluded with a discussion of the COSO's internal control framework and further explained its relationship to the federal government agencies. The next chapter presents the methodology of how the research was conducted for this study.

### **III. METHODOLOGY**

#### **A. INTRODUCTION**

This chapter defines the methodology used for this research study. The purpose of this research is to identify financial systematic issues surrounding the DoN's lack of auditability and its inability to obtain an unqualified opinion. Issues related to financial system frameworks in order to be audit-ready are explored. This research study explores and further analyzes possible reasons the DoN failed the audit, using the process and internal control components of the auditability triangle. The study uses a mixed-method strategy that includes an in-depth literature review, subject matter expert interviews, and analysis of qualitative and quantitative data from operational commands. Although it was not the focus of the research, a review of appropriations was conducted to provide an example of feeder system errors. The information collected in this research includes audit readiness procedures, internal controls, and financial feeder systems processes. The Institutional Review Board (IRB) approved the determination letter stating that this research study does not involve human subject research. This chapter explains how information was retrieved by reviewing and analyzing documents such as peer-reviewed articles, government documents, and other related studies. The data from financial feeder system accounting records from individual Marine Corps units were also reviewed and analyzed, even though this was not the focus of the research, and it was only used for illustration purposes. The next section presents a discussion of the literature review conducted and what documents were needed to better understand auditability, financial feeder systems and processes, and internal controls.

#### **B. LITERATURE REVIEW**

Government documents and studies reviewed included Government Accountability Office (GAO) reports, DoD Inspector General (DoDIG) reports, and DoD financial audit reports, which provided information on the current findings leading up to and during the DoD 2017 and 2018 audits. This research included a review of scholarly research literature related to financial statements and government documents to provide a foundation of

knowledge into the requirements needed to be audit-ready. This research study utilized the instructions and procedures from the Office of the Secretary of Defense (OSD), the DoD, Federal Accounting Standards Advisory Board (FASAB), and GAO reports. The scholarly articles also contributed to the understanding of internal controls. Furthermore, government documents provided information about the variety of financial feeder systems currently used in the DoN and DoD. The next section presents a discussion of the process used in collecting information from conducting interviews.

### **C. CONDUCTING INTERVIEWS**

Interviews with subject matter experts were conducted to better understand the processes of various DoD entities on audit readiness, currently used financial feeder systems and processes, and internal controls. Appropriate questions were developed to address these three main topics of interest for the first step in this process. Next, it was essential to determine the best individuals to interview who had day-to-day interactions with all three topics. Conducting the interviews, transcribing the interviews, and then analyzing the information were all part of this process. After the completion of the interviews, an analysis of the interviewees' responses was conducted to determine the current state of audit readiness in certain DoD entities. This analysis consisted of reviewing the commonality between the responses given by agency financial management personnel to the predetermined interview questions. Those interviewed held a position within the government financial management community and utilized financial management systems on a daily basis. The next section discusses how qualitative data was collected and analyzed.

### **D. DATA COLLECTION AND ANALYSIS**

Tracking, reporting, and execution of funding presents a realistic picture of resource utilization and management across organizations. Therefore, following the money was a key component to understanding where potential issues are taking place inside of the DoN's financial system. This research uses qualitative and quantitative data, and the purpose of reviewing this data was to determine the impact on the DoN's audit readiness, feeder systems and processes, and internal controls.

## 1. Qualitative Data

Qualitative data was collected from interviews conducted in DoN financial management units with comparable levels of responsibility. The qualitative data was analyzed based on responses provided by subject matter experts in operational Navy and Marine Corps commands in order to conduct a trend analysis. The interviews were developed to collect qualitative information to address the research questions, which include audit readiness, feeder systems and processes, and internal controls.

## 2. Quantitative Data

Financial execution data was requested from different DoN commands to analyze the possibility of systematic issues. The data collected was broken down into appropriations, and consequently into error reports. The analysis was used to provide an example for illustration purposes only. It was not the focus of this research.

## **E. SUMMARY**

This chapter discussed the methodology for this research study. This chapter also discussed the literature review that was conducted using scholarly articles; government documents; and reports related to audit readiness, internal controls, and financial feeder systems and processes. The chapter discussed the collection of data from subject matter expert interviews and the quantitative data from financial feeder systems to report systematic issues. The next chapter discusses the findings and analysis of the research. It also discusses the implications and recommendations based on the results of the analysis.

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## **IV. FINDINGS, ANALYSIS, AND RECOMMENDATIONS BASED ON ANALYSIS**

### **A. INTRODUCTION**

This chapter discusses the findings, analysis of findings, and recommendations based on the research findings. First, the chapter discusses the findings based on the interviews conducted with financial management personnel in different Navy and Marine Corps commands. The findings are organized in the three main categories for this study. The three categories are audit readiness, financial feeder systems and processes, and internal controls. Next, an analysis of these findings is presented. Finally, recommendations based on research findings are provided.

### **B. FINDINGS**

The information gathered from the 10 individuals within three different DoN organizations provides the data displayed in the table and figures showing the status of the current state of audit readiness, financial feeder systems and processes, and internal controls currently being implemented. The table and figures, each representing individual topics, were developed from the responses provided by the individuals interviewed. In addition to the interviews, financial reports were analyzed and are summarized in Table 2. The following findings reflect the issues generated by the current financial management infrastructure.

#### **1. Audit Readiness**

Regarding audit readiness and auditability as reflected in Figure 9, of those interviewed, the most used control by organizations are internal audits (80%), and the least used control is the conduct of the Tri-Annual Review (30%). Based on the literature review, accuracy in the financial reporting as well as completeness of all financial transactions were issues.



Figure 9. Interview results for question 1.1. What is your organization's process to be audit ready?

In addition, of those interviewed, 70% stated that their agency was following prescribed instructions while preparing to be audit ready. Fifty percent of those interviewed stated that they follow checklists that were created internally to their organization, and 40% followed the Financial Improvement and Audit Readiness (FIAR) program to ensure compliance.

As mentioned in the COSO, documentation for transactions is essential for an organization to be auditable (2013). Figure 10 reflects the types of evidence and documentation that organizations are using to track financial transactions reflected in the accounting system or changes to existing transactions such as increases or decreases. Of those interviewed, 60% use tracking methods that are not specified in current financial management guidance to support financial transactions. Thirty percent of the interviewees

record changes with receipts and checklists, while 40% use an internally created tracking mechanism, such as Excel spreadsheets.

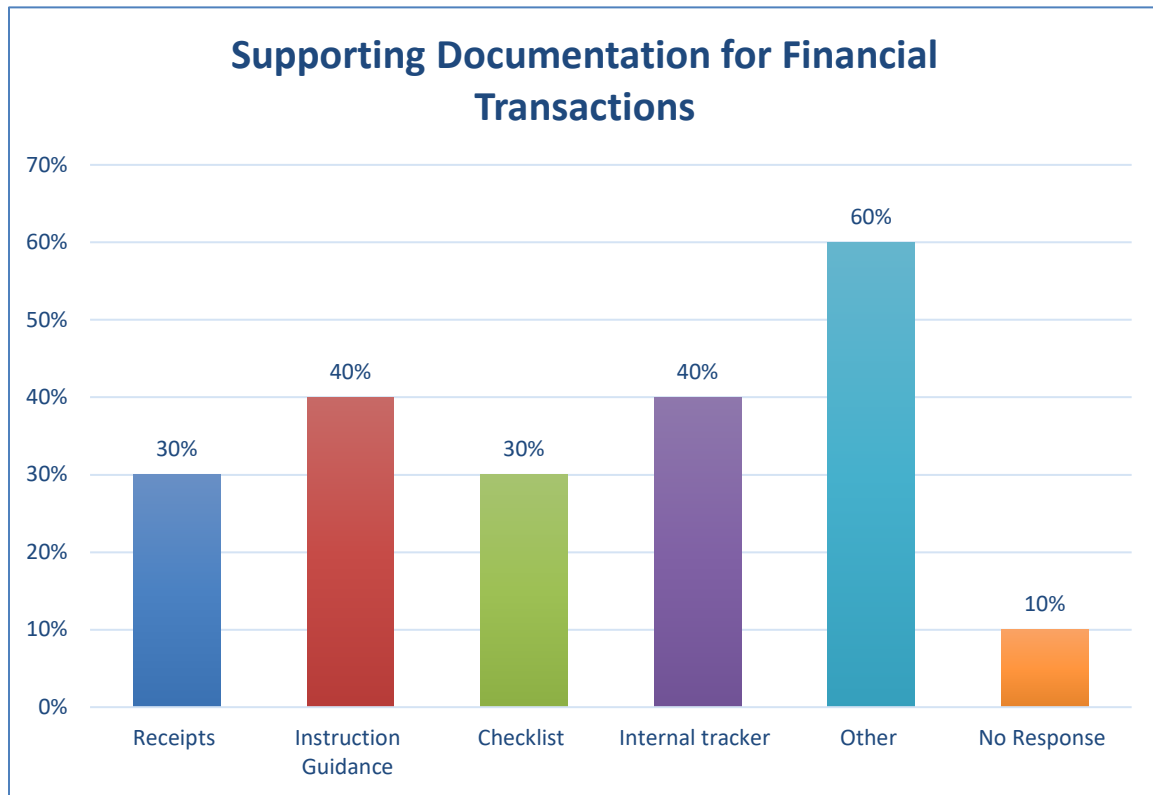


Figure 10. Interview results for question 1.3. What supporting documentation does your organization use for any type of changes to the financial transactions?

In the next section, financial feeder systems and interface issues between feeder systems and the general ledgers will be discussed.

## 2. Financial Feeder Systems and Processes

This research identified the current plan in place to modernize the DoN's accounting system and processes; this plan is currently known as the Financial Management Systems Consolidation Action Plan (Deputy Assistant Secretary of the Navy, 2019). The initial stage of the plan includes the Navy's transition from the current accounting system, Standard Accounting and Reporting System (STARS), to the Marine



Corps Accounting System, Standard Accounting Budgeting and Reporting System (SABRS) and in due time, moving the entire DoN financial operations to the Enterprise Resource Planning (ERP) system. According to DoN Officials', the transition to ERP is already taking place; however, the operational forces have not received the new system or any of the training required to operate it.

*a. Financial Reports from Feeder Systems*

As reflected in Figure 11, organizations constantly use reports from feeder systems to augment the reports generated by the general ledgers. Of those interviewed, fifty percent use reports generated by the feeder systems on daily reporting, 30% for weekly, and 30% for monthly reporting. Seventy percent of those interviewed use external reports to reconcile the execution reflected in the general ledger with the information in the feeder systems, 30% used the reports to create or augment their status of funds report, and only 40% percent use the reports for other purposes such as internal analysis. Finally, 10% of those interviewed did not provide an answer.

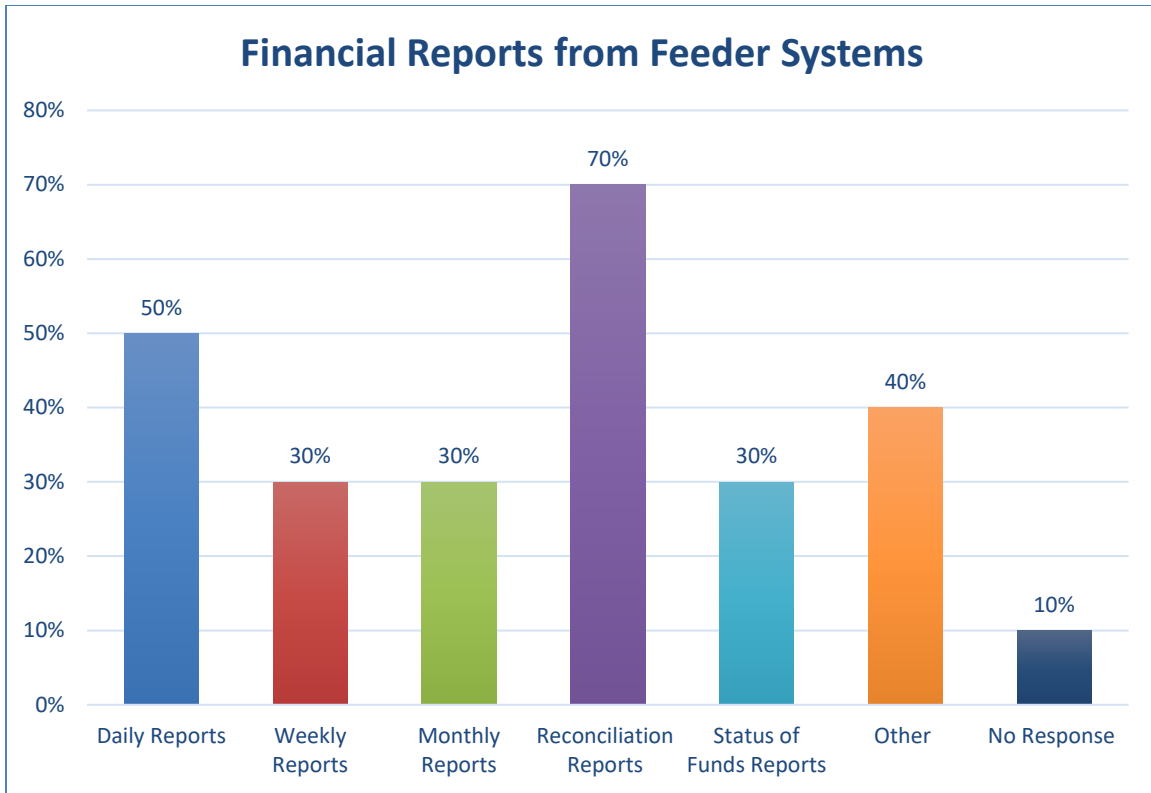


Figure 11. Interview results for question 2.2. What types of financial reports are generated using the data provided from the feeder systems?

*b. Relevance of reports from Feeder Systems*

As reflected in Figure 12, organizations create additional reports from feeder systems when reporting information up and down the chain of command. Eighty percent of those interviewed pull reports from feeder systems as additional data to complement information from other sources, 70% use the reports to compile data external to the general ledger, 60% use the reports to ensure financial data is accurate, and 80% use the reports for better and more accurate reporting. Ten percent of the individuals interviewed use the reports to improve financial performance, and 20% of them did not provide a response.

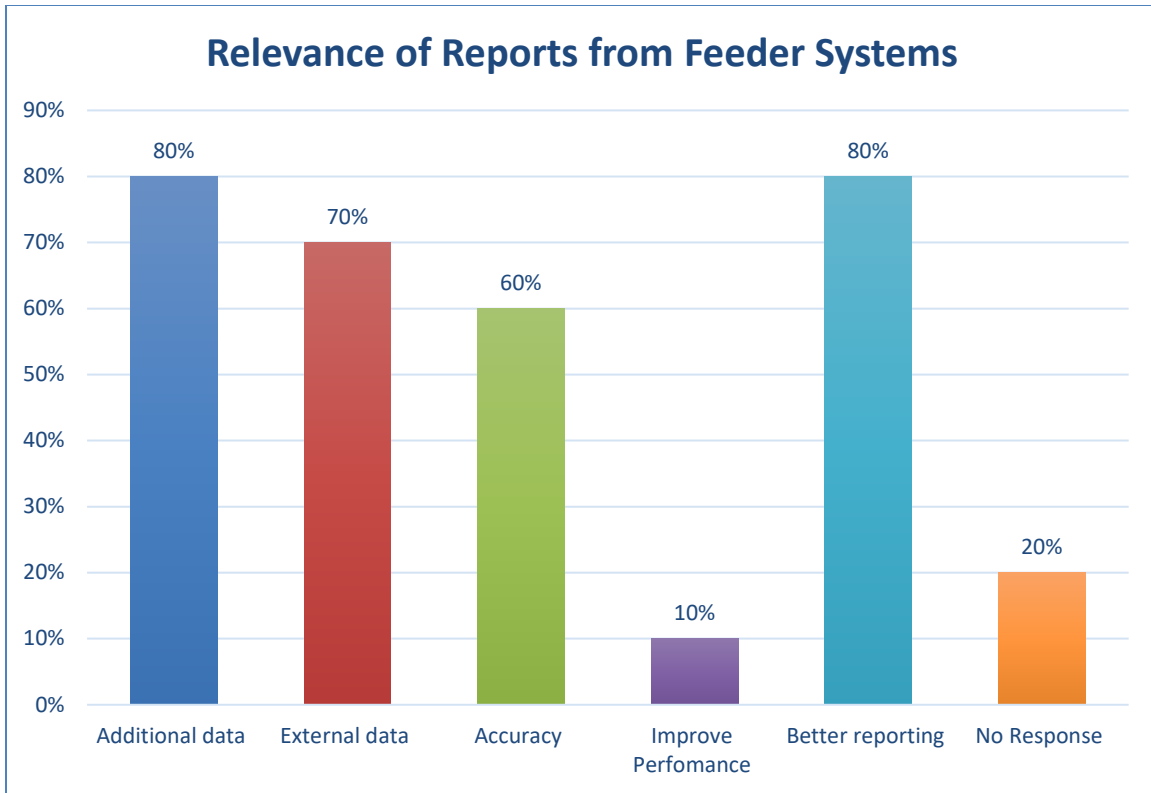


Figure 12. Interview results for question 2.3. What is the relevance of these financial reports?

*c. Example of Feeder System Errors for Illustration Purposes*

Reflected in Table 2, data was collected from six types of funding appropriations over a five-year period in order to provide an example to be used as illustration of the systematic issues from feeder systems. The table shows that an estimated \$45 million of reversions took place due to posting errors resulting in those funds being returned to the U.S. treasury. Some of the appropriations on the left side of the chart include Operation and Maintenance, Military personnel, Reserve personnel, Procurement, and other types of funding allocated to the Marine Corps.

Table 2. USMC reverted balance from MILSTRIPS

APPROPRIATION (TYPE OF FUNDS)	2014	2015	2016	2017	2018	GRAND TOTAL
Military Personnel, Marine Corps (MPMC) (1105)	(\$478,388.08)	(\$5,670,715.07)	(\$27,895.41)	(\$245,171.93)	(\$3,122,112.64)	(\$9,544,283.13)
Operation and Maintenance, Marine Corps (O&M,MC) (1106)	(\$4,288,120.64)	(\$5,227,563.98)	(\$1,557,135.14)	(\$5,296,563.29)	(\$14,867,711.14)	(\$31,237,094.19)
Operation and Maintenance, Marine Corps Reserve (O&M,MCR) (1107)	(\$656,510.86)	(\$219,038.60)	\$164,083.13	(\$327,072.14)	(\$682,056.41)	(\$1,720,594.88)
Procurement, Marine Corps (PMC) (1109)			\$19,859.40	(\$5,658.00)		\$14,201.40
Research, Development, Test, and Evaluation, Navy (RDT&E,N) (1319)		(\$83.50)	(\$6,624.69)	\$1,795.09		(\$4,913.10)
Reserve Personnel, Marine Corps (RPMC) (1108)	\$484,698.74	(\$1,306,682.27)	(\$981,379.78)	(\$149,261.27)	(\$697,096.12)	(\$2,649,720.70)
<b>GRAND TOTAL</b>	<b>(\$4,938,320.84)</b>	<b>(\$12,424,083.42)</b>	<b>(\$2,389,092.49)</b>	<b>(\$6,021,931.54)</b>	<b>(\$19,368,976.31)</b>	<b>(\$45,142,404.60)</b>

\*Raw data used to create this table was obtained from Headquarters Marine Corps Office illustrating six types of funding appropriations over a five-year period.

The next section presents a discussion of the internal control findings.

### 3. Internal Controls

Based on the literature review, the control environment and risk assessment components of the integrated internal control framework were found to be weak. This research identified the controls used by organizations in order to provide proper financial reporting. Although the DoD has mandated specific internal controls across departments, this research found that commands focus on only three main areas. The three areas of focus are internally created checklists, the Manager's Internal Control Program (MICP), and internal audits. Additionally, some commands find other ways to create internal controls such as additional checklists or repetitive work in an attempt to improve their operations.

Figure 13 reflects the current internal control practices that are being used to guide proper financial reporting accountability. Of those interviewed, 60% indicated that there is a MICP in place to ensure practices are being followed for audit readiness. In addition, 60% of those interviewed also indicated that their organization conducts internal audits. Fifty percent of those interviewed stated that they follow an internal controls checklist, and 20% stated that they use other means to guide proper financial reporting such as documents generated from external feeder systems.

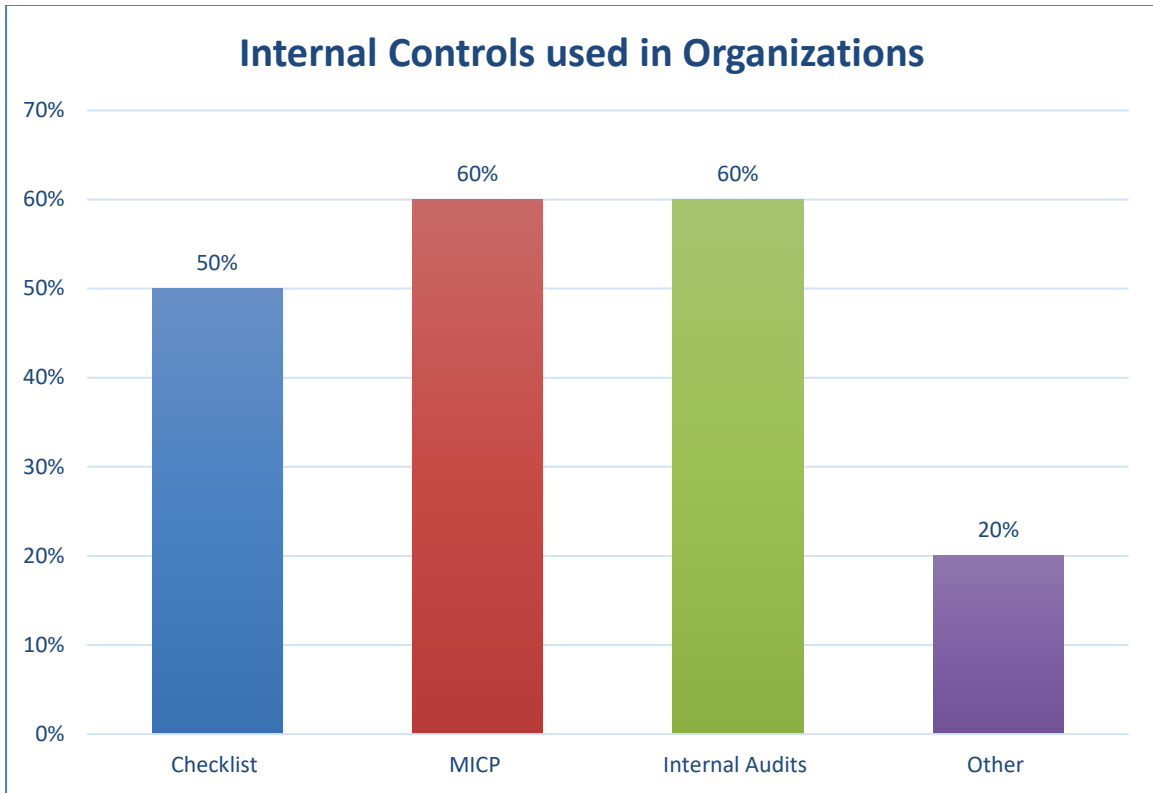


Figure 13. Interview results for question 3.1. What are the internal controls within your organization to guide proper financial reporting accountability?

Figure 14 reflects the steps that organizations are taking to become audit ready since the release of the DoD directive. Of those interviewed, 60% stated that changes were made to their internal control procedures, and 50% stated that new regulations were implemented to ensure procedural compliance.

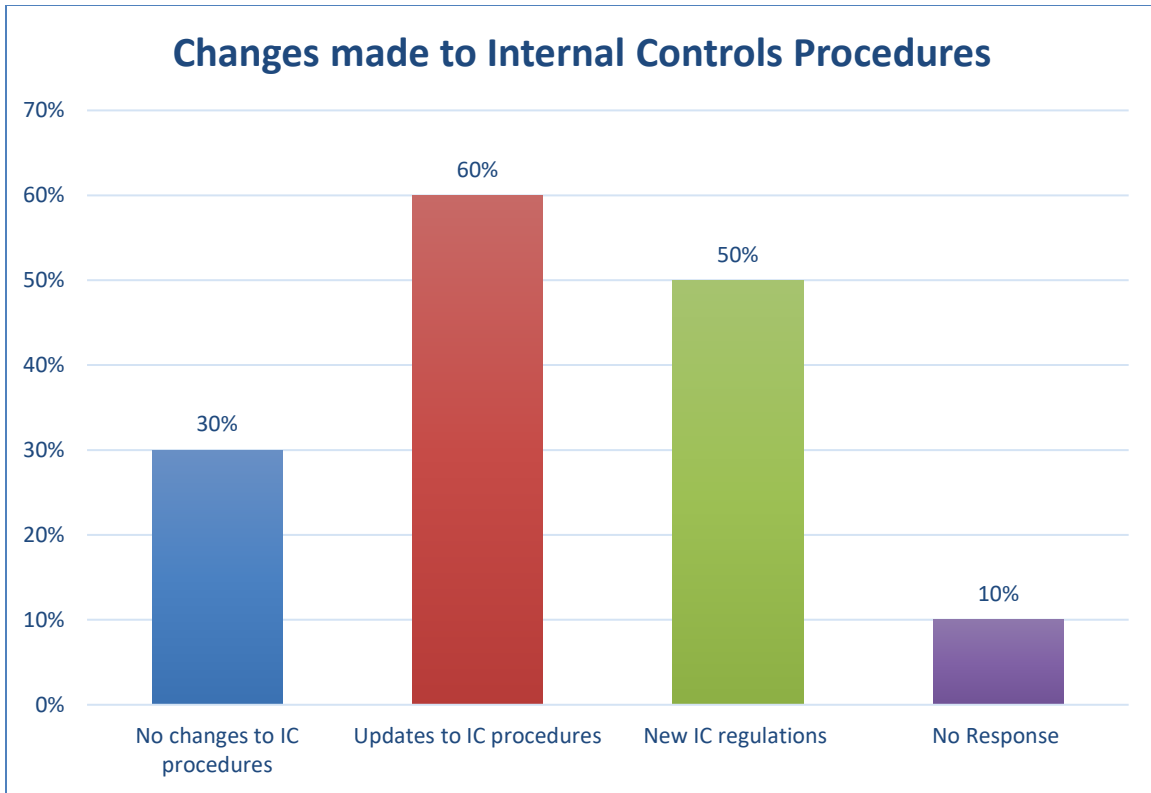


Figure 14. Interview results for question 3.2. What changes have been made to internal controls to meet the organization's goals/objectives?

The next section discusses the analysis of findings and the implications of these findings.

### C. ANALYSIS OF FINDINGS AND IMPLICATIONS

The completion of an integrated audit of the Navy and Marine Corps team continues to be a major challenge for the organization. This section discusses the analysis of findings related to audit readiness, financial feeder systems and processes, and internal controls. Based on the research findings, systematic issues caused by the current financial infrastructure have a negative impact on the DoN's ability to be audit ready, reduce the effectiveness of financial feeder systems and processes, and present great challenges for effective internal controls.

## 1. Audit Readiness

An analysis of the finding indicates that the use of internal audits, at 80%, is the primary way commands prepare for the financial audit. Although internal audits can be helpful, they are not always in accordance with the GAGAS; therefore, internal audits may be ineffective in preparing the DoN for the mandated financial audit. Based on the research findings, the current process to prepare for the financial audit presents disparities between policy and procedures actually being practiced. Organizations across DoN prepare for an external financial audit by conducting their own internal audits, which often fail to follow the proper regulations. In order to be auditable, the DoN needs to have competent people, capable processes, and effective internal controls (Rendon & Rendon, 2015). Additionally, DoN organizations are required to produce and maintain accurate and complete evidence and documentation for every transaction in the funding life cycle. However, based on the responses from the interviews in Figure 10, 60% of the personnel use other types of supporting documents for their financial transactions, which presents one of the issues preventing the DoN from achieving an unqualified opinion during its financial statement audit. Of those interviewed, only 30% stated that they conducted Tri-Annual Reviews.

These findings are directly related to the disparity between policy and execution since the conduct of the Tri-Annual Review is required by the DoD FMR (Department of Defense [DoD], 2017, June). The DoN has yet to receive an unqualified opinion due to the failure to provide the appropriate auditable evidence and documentation to support the data reported on the government financial statements. If the DoD establishes a standardized financial system to support audit readiness efforts, then the DoN may be more capable of maintaining adequate evidence required for the audit, leading to more efficient use of resources and possibly obtaining an unqualified opinion.

## 2. Financial Feeder Systems and Processes

As reflected in Figure 11, organizations must use data external to the general ledger to augment reports at many different times and levels. Using data external to the accounting system reflects the lack of interface and the need for additional features in the general ledger process. However, the additional work required to compile additional data and



create additional reports does not provide higher performance for organizations. As reflected in Figure 12, only 10% of organizations follow the practice to improve their financial performance. Additionally, having to create reports or supporting documentation from multiple sources is cumbersome. The additional reports that come from feeder systems reflect the inability to provide timely and accurate data during audits. As illustrated in the Auditability Triangle “institutionalized, measured, and improved processes” are vital to audit readiness (Rendon & Rendon, 2016, p. 755).

This research identified interface issues between financial feeder systems and the accounting systems. A significant finding, previously identified in Table 2, reflects changes to MILSTRIPS and how they are captured in the supply systems but not in the accounting systems. As a result of changes in the system, the Marine Corps reverted over \$45 million from MILSTRIPS at the end of FY2018, which results in direct impacts of purchasing power of goods and services to support Marines and sailors. The total amount of funds reverted by the Marine Corps resulted in funding that cannot be used for future purchases or payments of existing obligations. The cost of this systematic issue is substantial and takes away the commands’ ability to manage funds efficiently and effectively.

### 3. Internal Controls

Out of the nine areas that reflect material weaknesses in the *USMC FY2018 Agency Financial Report*, four are directly related to internal controls failures. According to the report, “the Marine Corps presents material weaknesses in entry level controls, ability to provide complete, timely, and sufficient evidence due to internal controls, has not implemented controls to accurately define its financial reporting procedures and finally, lacks proper controls to account for operating materiel and supplies” (United States Marine Corps, 2018). Internal control failures have led directly to lack of audit readiness and affect the interaction between financial feeder systems and the accounting systems. Based on the research findings, organizations have been forced to change many internal controls procedures since the most recent audit resulted in a disclaimer of opinion, which addressed the fact that internal controls are not effective. As illustrated in the Auditability Triangle

“enforced, monitored, and reported internal controls” are crucial to audit readiness (Rendon & Rendon, 2016, p. 755).

As found in the literature review, the control environment and risk assessment components of the integrated internal control framework were found to be weak. Based on this research, the DoN does not adequately address internal controls or consider official regulations such as the *Green Book* requirements when designing or implementing internal controls. Commands have made or requested significant changes to policy and guidance for internal control procedures to properly guide financial reporting throughout the DoN. Figure 14 shows that 60% of those interviewed indicated that updates to procedures were the leading change to internal control policies and processes. The second change, required by 50% of those interviewed, are new internal control regulations in support of internal control procedures. Thirty percent of personnel interviewed indicated that they have not seen any changes to their internal controls. The need for updated or new internal control policies is a clear indication that the current policies and procedures are not effective. Hence, the DoN does not have the appropriate internal controls in place to achieve an unqualified audit opinion.

#### **D. RECOMMENDATIONS BASED ON RESEARCH FINDINGS AND ANALYSIS**

These recommendations, based on the research findings, focus on standardization and compliance with the corresponding regulations in the areas of audit readiness, financial feeder systems and processes, and internal controls.

Audit Readiness: As reflected in Figure 9, only 40% of those interviewed currently have a FIAR programs established. In addition, 30% currently conduct the required Tri-Annual Review, and only half of those interviewed follow internally created checklists. Therefore, DoN should make audit readiness a focus of effort in their current guidance in order to provide its units with a clear path and officially guide them to achieve a complete financial audit. Additionally, it is recommended that the DoN consider creating internal teams to focus on compliance with the current policies and procedures.

Financial Feeder Systems: The DoN's ability to track and report financial transactions and execution of appropriated funds directly reflects the ability to support Marines and Sailors in the operational forces. According to John Graveen, who currently serves as the Deputy Assistant Secretary of the Navy, Financial Policy and Systems, the DoN should continue its efforts to consolidate general ledgers and financial feeder systems (J. Graveen, personal communication, July 17, 2019). According to the example presented in Table 2, the ability to update transactions across all stages of the funding life cycle should be a priority. Therefore, it is recommended that the DoN consolidate the current accounting and feeder systems and standardize the processes for the execution of financial resources. Consolidation will allow commands to properly code financial transactions to ensure reporting is standardized across all agencies of DoD as reflected in the process component of the auditability triangle. Additionally, this process would assist in minimizing future errors and reversions and would support the Program Objective Memorandum (POM) process. Standardization of the process would assist the financial audit process since it allows auditors to gain a better understanding of financial data across the DoN.

Internal Controls: As reflected in Figure 13, Internal Control programs and efforts are not standardized, and the lack of compliance continues to make established programs ineffective. Therefore, DoN should focus its internal control efforts on enforcement, implementation, and training. The DoN should enforce existing internal control regulations and provide updates to internal controls to reflect the continuously changing environment. The DoN should also train appropriate personnel in internal control procedures and regulations to improve the ability to become audit ready and ensure the DoN is within compliance of both federal and corporate standards.

## **E. SUMMARY**

This chapter discussed the finding, analysis, and recommendations based on the research findings and analysis. First, the research findings were presented. Next, the findings as they relate to audit readiness, financial feeder systems and processes, and internal controls were analyzed. Finally, based on the analysis of these findings,

recommendations were provided. Table 3 provides a summary of the recommendations based on the research findings and analysis. The next chapter summarizes the research, presents the conclusion, and identifies areas for further research.

Table 3. Summary of research recommendations.

Section	Recommendations
Audit Readiness	Compliance 1. DoN should focus on complying with directed policy to be audit ready
Feeder Systems and Processes	Consolidation and Standardization 1. DoN should consolidate financial and feeder systems 2. DoN should standardize processes for the execution of financial resources
Internal Controls	Enforcement, Implementation, and Training 1. DoN should enforce existing regulations 2. DoN should implement new Internal Controls regulations 3. DoN should train appropriate personnel in Internal Control procedures and regulations

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## **V. SUMMARY, CONCLUSIONS, AND AREAS FOR FURTHER RESEARCH**

### **A. SUMMARY**

The focus of audit readiness and auditability can be traced back to the early 1980s. The Federal Managers' Financial Integrity Act (FMFIA) of 1982 mandated that agencies create internal controls and financial systems that operated around the concepts of providing reasonable assurance of effectiveness, compliance, and reliability for financial statements (General Services Administration, 2012). These concepts provided a guidance for the Department of Navy (DoN) and Department of Defense (DoD) on how to establish a strong foundation for the development, recording, and maintenance of financial records. The purpose of this research was to identify financial systematic issues surrounding the DoN's and DoD's lack of auditability and the DoN's inability to obtain an unqualified opinion. Auditability theory states that an organization can reduce its vulnerability to fraud by emphasizing the competency of its personnel, developing capable processes, and establishing effective internal controls (Rendon & Rendon, 2015). This research study explores and further analyzes possible reasons the DoN and DoD failed the audit, using the process and internal controls component of the auditability triangle. Audit reports, DoN financial reports, accounting error reports, and reported financial systematic issues that contribute to audit issues were reviewed.

This research identified deficiencies in the policies, procedures, and internal controls of three separate DoN financial organizations. Based on the research findings, recommendations are provided to the Navy to improve their auditability and the financial feeder system consolidation plan.

### **B. CONCLUSIONS**

This research study focused on three research questions. Based on the findings of the research, the answers to these research questions are discussed next.

1. Using the auditability triangle theory, what are the audit readiness issues that led to the failed audit for the DoN?

As reflected in the analysis presented in this research, the financial management issues leading to a fail audit are accuracy and completeness. Organizations across the DoN are not following the same financial processes to conduct their business, causing inconsistencies in the reporting and time delays and consequently preventing the conduct of a complete audit. The process component of the Auditability Triangle focuses on agencies' vulnerabilities by emphasizing the capability of the organization's processes and the effectiveness of the organization's internal controls. Having a clear and properly designed process allows organizations to be prepared and comply with audit requirements and regulations. Organizations across the DoN follow a variety of procedures, some of which are not in line with the appropriate auditing regulations. As reflected in Figure 9, 80% of individuals interviewed were conducting internal audits. In addition, 70% stated they were following prescribed instructions. Only 40%, however, stated that there was a FIAR program set up in accordance to DoD instructions. Additionally, only 30% stated their organization participated in the Tri-Annual Review in accordance to DoD instructions. Therefore, auditors have been unable to conduct a complete financial statement audit.

2. Using the process component of the auditability triangle theory, what are the feeder systems and process issues that led to the failed audit for the DoN?

As reflected in the analysis presented in this research, the financial feeder system and process issues include consolidation and standardization. As shown in Figure 10, 60% of the individuals interviewed had other means to account for their ability to be audit-ready. Internal trackers and internal instruction guidance were used 40% of the time to document a change in a transaction. Only 30% of those interviewed used receipts and internal checklists. Given the limitations of this research study, the feeder systems and process issues leading to a failed audit of the DoN can be separated into two main categories. The first category focuses on the consolidation of general ledgers and the reductions of financial feeder systems. The second category focuses on the standardizations of processes by using codes to track and report financial transactions across the DoN. A full consolidation allows standard reporting for the annual budget submission and facilitates the conduct of a complete financial statement audit. Evaluating the adequacy of internal controls and the

process to becoming audit-ready would provide additional details in developing a standardized financial framework.

The Department of the Navy, Financial Management and Comptroller, Office suggests that fieldwork should include reviewing systems of internal controls and identifying the internal control issues (J. Graveen, personal communication, July 17, 2019).

3. Using the internal controls component of the auditability triangle theory, what are the internal control issues that led to the failed audit for the DoN?

As reflected in the analysis of this research, the financial management internal control issues leading to a failed audit are lack of internal control reliability, effectiveness, and compliance. The constant update of standard operating procedures reflects the lack of reliability and effectiveness of the current internal control regulations. Additionally, the difficulties in maintaining a clear line of communication across the organizations prevents compliance, creating a vast chasm between policies and procedures and ultimately preventing the completion of the mandated audit. As reflected in Figure 14, 60% of the individuals interviewed have updated their internal controls to meet the organization's goals and objectives of being audit ready. New regulations that were put in place were implemented by 50% of those interviewed. Those that were interviewed discussed common concerns with lack of transparency and lack of communication of priorities in the field. As reflected in Figure 13, Management Internal Control Programs (MICPs) and internal audits were completed by 60% of those interviewed. However, according to Table 2, nearly \$45 million was returned to Treasury due to erroneous postings. Finally, the inability for the vast amount of financial feeder systems to properly communicate to the general ledgers is a contributing factor in the failed audit as reflected in the DoN's annual financial reports and required by the COSO. Summarized in Table 4, are the research questions and the issues identified.



Table 4. Summary of research findings.

Research Questions	Findings
RQ1. Audit Readiness	Accuracy and Completeness 1. DoN lacks accurate financial statements 2. DoN lacks or has failed to provide complete evidence and documentation to support the financial statements
RQ2. Feeder Systems and Processes	Consolidation and Standardization 1. DoN has an extensive amount of feeder systems 2. DoN lacks standard feeder systems and processes
RQ3. Internal Controls	Reliability, Effectiveness and Compliance 1. DoN lacks reliable internal controls 2. DoN lacks effective internal controls 3. DoN is not complying with current internal control policies and procedures

### C. AREAS FOR FURTHER RESEARCH

There are several areas for further research that are suggested. One of the areas for further research should be focused on analyzing audit issues while considering the FIAR Plan, Chief of Naval Operations' audit goals, the 2018 DoN Audit-Relevant Systems Consolidation Action Plan, national strategic goals, and the guidance from the Commandant of the Marine Corps (CMC).

Another area for further research is to address the number of errors caused by the feeder systems at the lower levels. This research can be pursued by reviewing the interface of the accounting systems and financial feeder systems and the effects it will have on the financial reports that feed directly into the general ledgers (GL). This recommended research area will aid the DoD and DoN in identifying vulnerabilities in the internal controls and enhancing the auditability of government financial statements.

Yet another area for further research is for the DoN to consider a component-wide survey to incorporate a wider and more encompassing group of participants to fully understand the reasons of the failed audits and the disparities between internal controls and

practices currently in place. Participants must include feeder system users, MICP managers, and financial management personnel. The survey would allow the organizations to create new guidance and programs based on the needs of the force rather than the needs of the upper management.

Finally, this study should be revisited once the General Ledger Consolidation Plan for 2023 is in place. At the time of this writing, the consolidation of the financial feeder systems into the one GL system was in progress with an estimated goal of 2023. Additional analysis could focus on identifying the deficiencies in the consolidation plan and identifying feeder system constraints resulting in the need to use secondary stand-alone financial feeder systems. These findings might suggest a clearer picture of the true amount of money that is being lost due to misappropriations and non-allocations.

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## **APPENDIX A. UNITED STATES MARINE CORPS FISCAL YEAR 2018 AGENCY FINANCIAL REPORT**

This appendix was created using information from the United States Marine Corps Fiscal Year 2018 Agency Financial Report to provide a summary of the areas which led to a disclaimer of opinion during the FY18 financial audit.

### **INDEPENDENT AUDITOR’S REPORT**

To the Commandant of the United States Marine Corps and Inspector General of the Department of Defense

#### **Report on the Financial Statements**

We were engaged to audit the accompanying consolidated financial statements of the United States Marine Corps (Marine Corps), which comprise the consolidated balance sheets as of September 30, 2018 and 2017, the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources (hereinafter referred to as the “financial statements”) for the years then ended, and the related notes to the financial statements. (United States Marine Corps, 2018, p. 35)

#### **Basis for Disclaimer of Opinion**

We were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion that the financial statements are free from material misstatements when taken as a whole. The Marine Corps disclosed in Note 1, Significant Accounting Policies, instances where its current accounting and business practices represent departures from accounting principles generally accepted in the United States of America. As a result, the Marine Corps was unable to assert that the financial statements are presented fairly in accordance with accounting principles generally accepted in the United States of America. The Marine Corps asserted to the following departures from accounting principles generally accepted in the United States of America (p. 35):

- Accrual accounting requirements per Statement of Federal Financial Accounting Standards (SFFAS) No. 1, Accounting for Selected Assets and Liabilities, and SFFAS No. 5, Accounting for Liabilities of The Federal Government
- Recognition and valuation requirements outlined in SFFAS No. 3, Accounting for Inventory and Related Property

- Reporting requirements associated with presenting the statements of net cost by major program per SFFAS No. 4, Managerial Cost Accounting Standards and Concepts, as amended
- Contingent legal liability requirements outlined in SFFAS No. 5 and SFFAS No. 12, Recognition of Contingent Liabilities Arising from Litigation
- Recognition and valuation requirements outlined in SFFAS No. 6, Accounting for Property, Plant, and Equipment
- Recognition and accounting requirements associated with capital and operating leases and environmental liabilities described in SFFAS No. 5 and SFFAS No. 6
- Revenue recognition requirements outlined in SFFAS No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting
- Accumulation and capitalization of internal-use software following SFFAS No. 10, Accounting for Internal Use Software
- Accounting and reporting requirements associated with restatements per SFFAS No. 21, Reporting Corrections of Errors and Changes in Accounting Principles, and OMB Circular A-136, Financial Reporting Requirements
- Reporting and valuation requirements outlined in SFFAS No. 29, Heritage Assets and Stewardship Land, and disclosure requirements described in SFFAS No. 42, Deferred
- Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards No. 6, No. 14, No. 29, and No. 32
- Incomplete reporting entity following SFFAS No. 47, Reporting Entity. (United States Marine Corps, 2018, p. 36)

Additionally, the Marine Corps was unable to produce financial statements and disclosures in accordance with OMB Circular A-136. (p. 36)

**APPENDIX B. RECORDING OF TRANSACTIONS, ACCORDING  
TO MARINE CORPS ORDER (MCO) 7300.21B, *MARINE CORPS  
FINANCIAL MANAGEMENT STANDARD OPERATING  
PROCEDURE MANUAL***

This appendix was created using information from the Marine Corps Order 7300.21B, Marine Corps Financial Management Standard Operating Procedure Manual, to provide accurate definitions to the four phases of the transaction cycle used in the Marine Corps General Ledger.

3001. Financial Transaction Cycle. All financial events (transactions) processed in the accounting system enter through a four-phase process called the transaction cycle. (United States Marine Corps, 2015, p. 3–3)

Commitment: A firm administrative reservation of funds, based upon firm procurement directives, orders, requisitions, authorizations to issue travel orders, or requests which authorize the recipient to create obligations without further recourse to the official responsible for certifying the availability of funds. The act of entering into a commitment is usually the first step in the process of spending available funds. The effect of entering into a commitment and the recording of that commitment on the records of the allotment is to reserve funds for future obligations and is not a legally binding action. A commitment is subject to cancellation by the approving authority to the extent that it is not already obligated. (p. 3–4)

Obligation: An obligation is a firm, legally binding agreement between parties for the acquisition of goods or services. This phase is vital in that when an official document describing a financial transaction exists, the government is legally and contractually liable for the amount shown on the source document. Once funds are obligated, the official unobligated available balance of the Fund/RM's account is decreased. Commands creating obligations over authorizations could cause a violation of section 1517 of reference (c) at the level where the funding limitation is held. An obligation may be de-obligated when both parties agree and supporting documentation is provided to update the accounting system. (p. 3–4)

Expense: An expense occurs when material and services ordered are received and accepted by a designated authorized receiving point. The expense amount creates the accounts payable amount in the accounting system and controls the amount billed for reimbursable transactions. (p. 3–4)

Liquidation: The payment for goods or services that were ordered and received. Liquidations or payments are made after the finance officer receives an invoice from a vendor or government agency requesting payment. (p. 3–4)

## APPENDIX C. KEY PERFORMANCE METRICS

This appendix was created using information from Department of Defense Financial Management Regulation and the Marine Corps Order 7300.21B, *Marine Corps Financial Management Standard Operating Procedure Manual*, to provide accurate definitions to the key performance indicators used across the Department of the Navy and the Marine Corps.

Disbursements: While a single payment may be charged to multiple lines of accounting, each amount charged to a separate line of accounting is treated as a separate disbursement and must be matched to its corresponding obligation. (DoD, 2017, June, p. 11–6)

- Negative Unliquidated Obligations (NULO): A disbursement transaction that has been matched to the cited detail obligation, but the total disbursement(s) exceeds the amount of that obligation. (DoD, 2017, June, p. 11–6)
- Unmatched Disbursements (UMD): A disbursement transaction that has been received and accepted by an accounting office, but has not been matched to the correct detail obligation. This includes transactions that have been rejected back to the paying office or central disbursement clearing organization by an accounting office. (DoD, 2017, June, p. 11–7)

SABRS Error File Correction Process: Transactions posted to the accounting system via an interface go through various internal edit checks prior to posting. Those transactions that do not meet the edit check criteria will process to various error reports (e.g., Spending Error Transaction Report, CIF Errors). The accounting system will assign error codes to those transactions that fail the edit checks when processed. Comptroller Offices and fund holders should generate the error reports from SMARTS and take immediate and appropriate action to correct the errors and implement process improvements to address the root cause. All actions taken in regard to error correction must be documented in sufficient detail to provide an auditable trail that describes the issue and basis of corrective actions. (United States Marine Corps, 2015, p. 10–7)

Abnormal and Aged Transactions: This section covers financial conditions that result in an abnormal accounting transaction or accounting balance and the procedures required to correct and reconcile those conditions. Abnormal accounting transactions and accounting balances are key trend analysis



indicators of process, procedure, and/or training shortfalls that require command attention. The analysis and corrective actions for these transactions and balances are conducted by the command's FMRO. (United States Marine Corps, 2015, p. 10–8)

#### Reimbursable and Direct Cites:

- Reimbursable: DoD activities may furnish the sale of material, work, and services to other DoD Components, Federal Agencies, or public sources on a reimbursable basis pursuant to public laws and DoD policies. There are two basic types of reimbursable orders: Economy Act/Non-Economy Act Orders and Project Orders, which can further be broken down into Automatic or Specific reimbursables. (United States Marine Corps, 2015, p. 5–3)
- Direct Cites: The Direct Cite process in SABRS provides a means for Marine Corps commands to transfer funding to another Marine Corps command without having to create, authorize, and issue a reimbursable order or by having a funding transfer occur between the authorities. This process is only used when the funding is between two Marine Corps activities. If funding is to be provided to another DoD activity or government agency, a reimbursable order must be created to issue funding. (United States Marine Corps, 2015, p. C-4)

#### Interests and Discounts:

- Interests Penalties: When DoD Components fail to make payment by the payment due date, interest accrues from the day after the payment due date through the payment date. (DoD, 2017, p. 7–10)
- Interest Payment Funding: DoD will pay any late payment interest penalties from either the funds available for the administration of the program for which the penalty was incurred (refer to 5 CFR 1315.10(b)(5)), or from funds financing the operation of the military department or defense agency with which the invoice or contract payment is associated (refer to 31 U.S.C. § 3902). All interest payments will be charged to the fiscal year(s) in which they accrue. If the interest is accrued at the end of the fiscal year, but not paid until the beginning of the next fiscal year, the prior year's funds will be cited. If interest is accrued at the end of the fiscal year, and additional interest is accrued in the new fiscal year, the total interest penalty will be funded citing each respective fiscal year's funds where the interest was accrued, thus ensuring the interest fund cite represents the bona fide need of the year in which the obligation arises. If the appropriation to which the interest would otherwise be charged is cancelled, the appropriation current on the date of

payment will be charged pursuant to 31 U.S.C. § 1553 (b)(1). (DoD, 2017, p. 7–12)

- Discounts: If a vendor/contractor offers a DoD Component a discount, whether stipulated in the contract or offered on an invoice, the Component should take the discount if economically justified, but only after acceptance has occurred. (DoD, 2017, p. 7–10)

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## APPENDIX D. DON SABRS (SV-01 SYSTEMS INTERFACE DESCRIPTION [DM2])

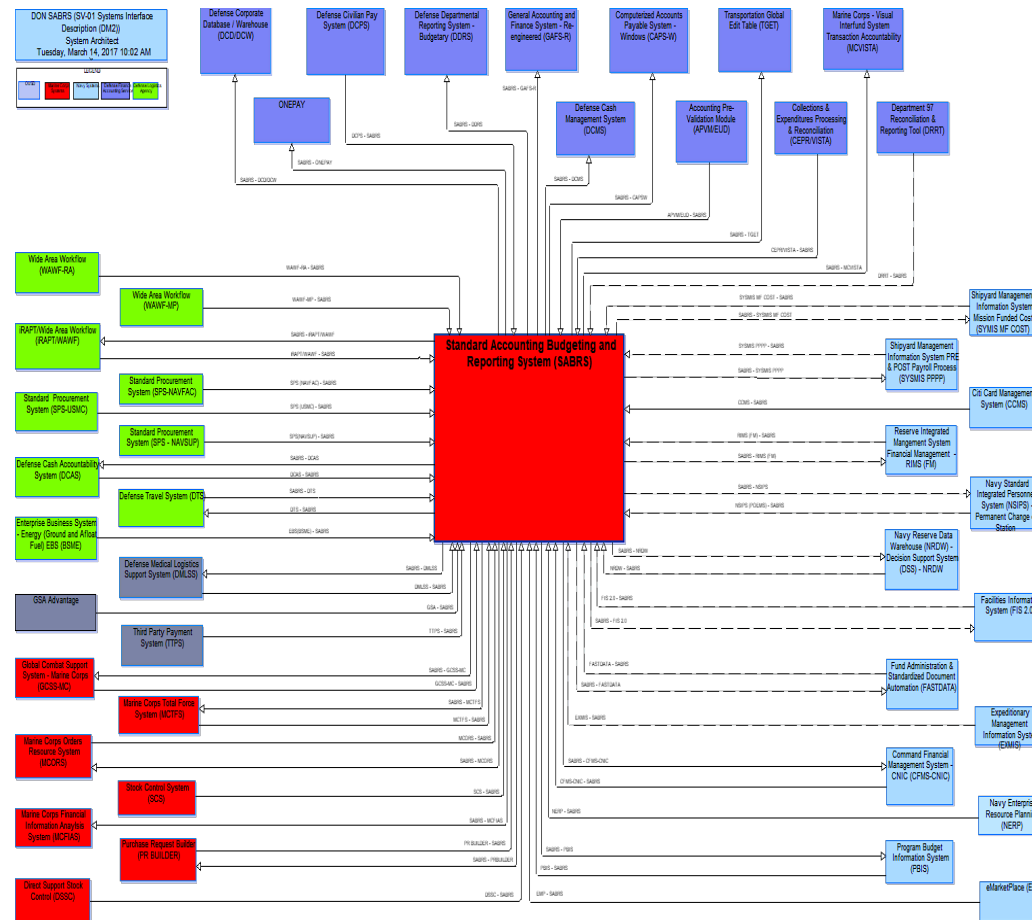


Figure 15. DoN SABRS Systems Interface. Source: Kuhfahl & Hartfiel (2017).

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